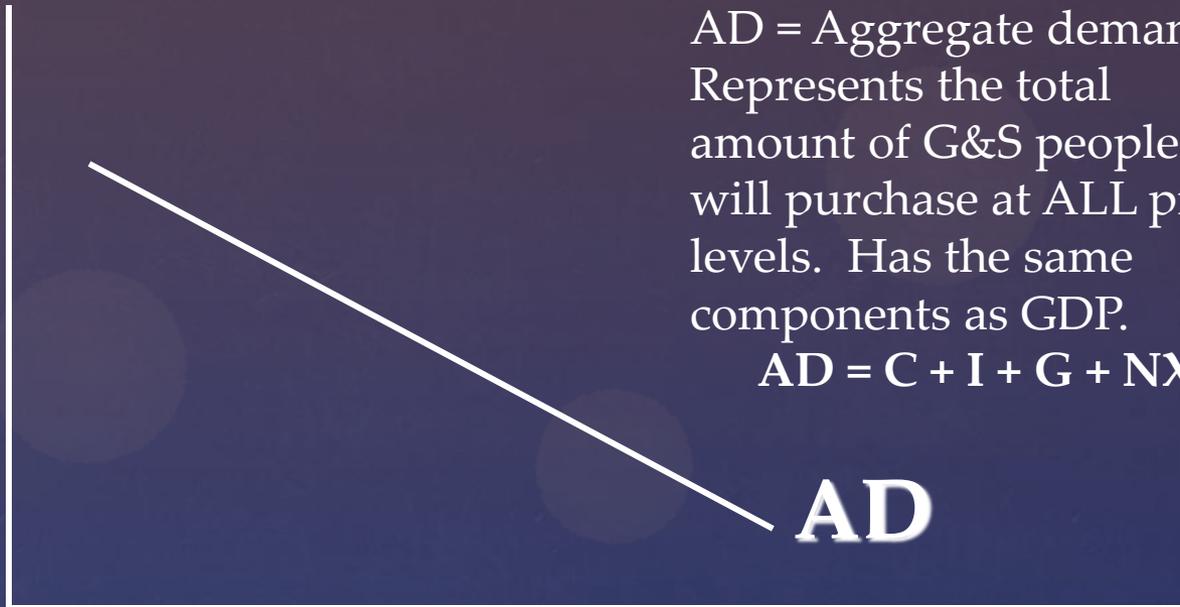


{ Aggregate
Demand &
Aggregate
Supply

AD - The Model

PL

PL = Price Level.
Reflects ALL prices in the economy!



AD = Aggregate demand.
Represents the total amount of G&S people will purchase at ALL price levels. Has the same components as GDP.

$$AD = C + I + G + NX$$

AD

RGDP

Real Gross Domestic Product = The dollar value of ALL domestically produced final goods and services adjusted for inflation

The Model



Why the downward slope?

1. As price levels rise, so does demand for money to pay those price levels. As demand for money increases, interest rates increase. When IR increase, quantity of I and C decrease. **(Interest Rate Effect)**
2. As price levels rise, REAL wealth decreases and people purchase less stuff. **(Real Wealth Effect)**
3. As price levels rise, foreign goods are relatively cheaper, therefore increasing the quantity of imports at any one price level. **(Net Export Effect)**

***SLOPE IS BASED ON PRICE CHANGES!!!! NOT CHANGES TO C, I, G, NX!!!!**

What changes AD?

- ⌘ Any change in C, I, G, NX
 - ⌘ Fiscal policy
 - ⌘ Consumer/Business expectations
 - ⌘ Autonomous investment injections
 - ⌘ Income changes (for C, I, OR G)
 - ⌘ Relative price change of foreign goods
 - ⌘ Interest rates (via a change in C or I)

AS - The Model

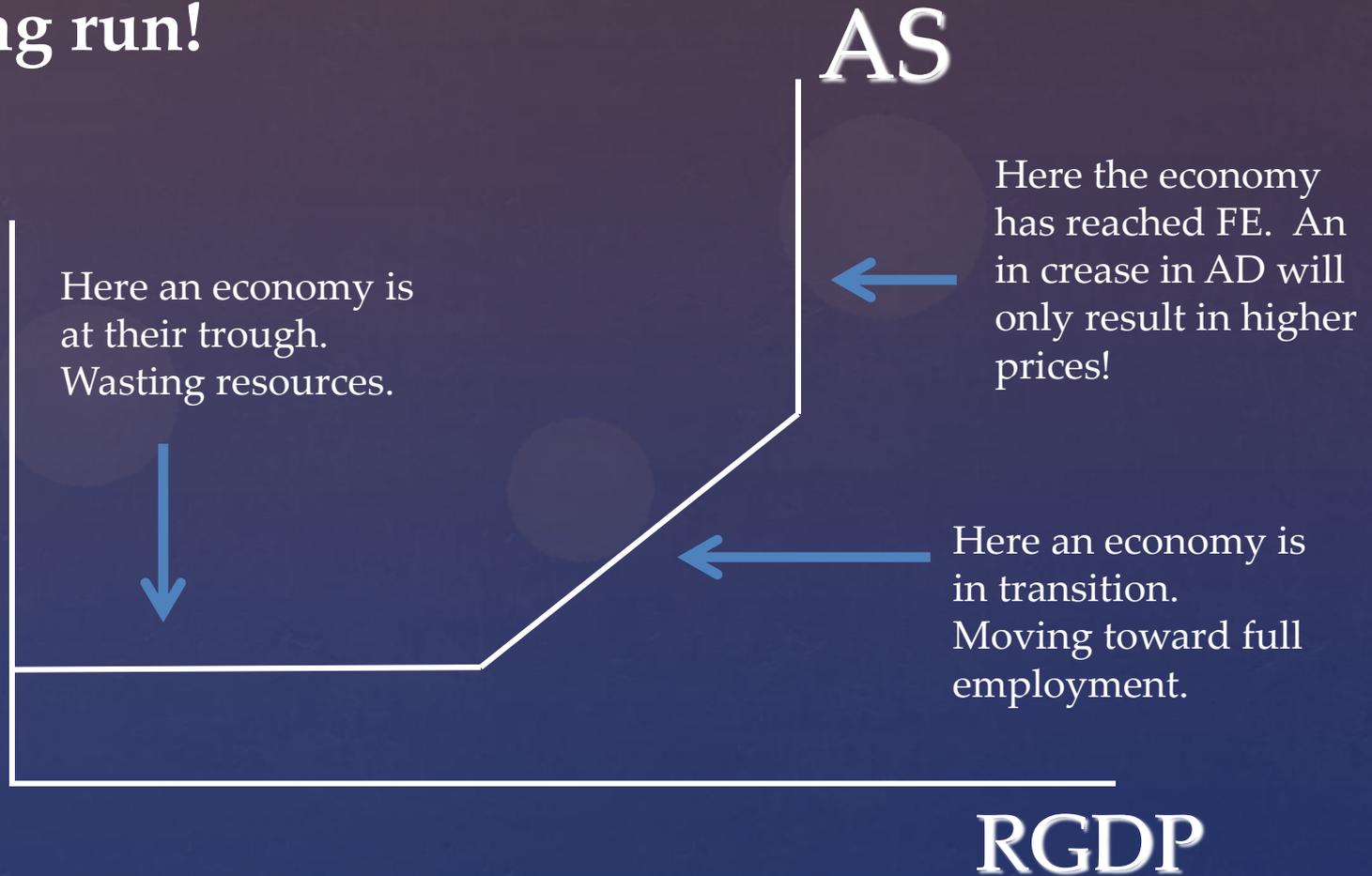
AS = Aggregate supply.
The total amount of goods and services businesses will provide at ALL possible price levels



AS - The Model – Not so fast!

Aggregate Supply can change in the short run
vs. the long run!

PL



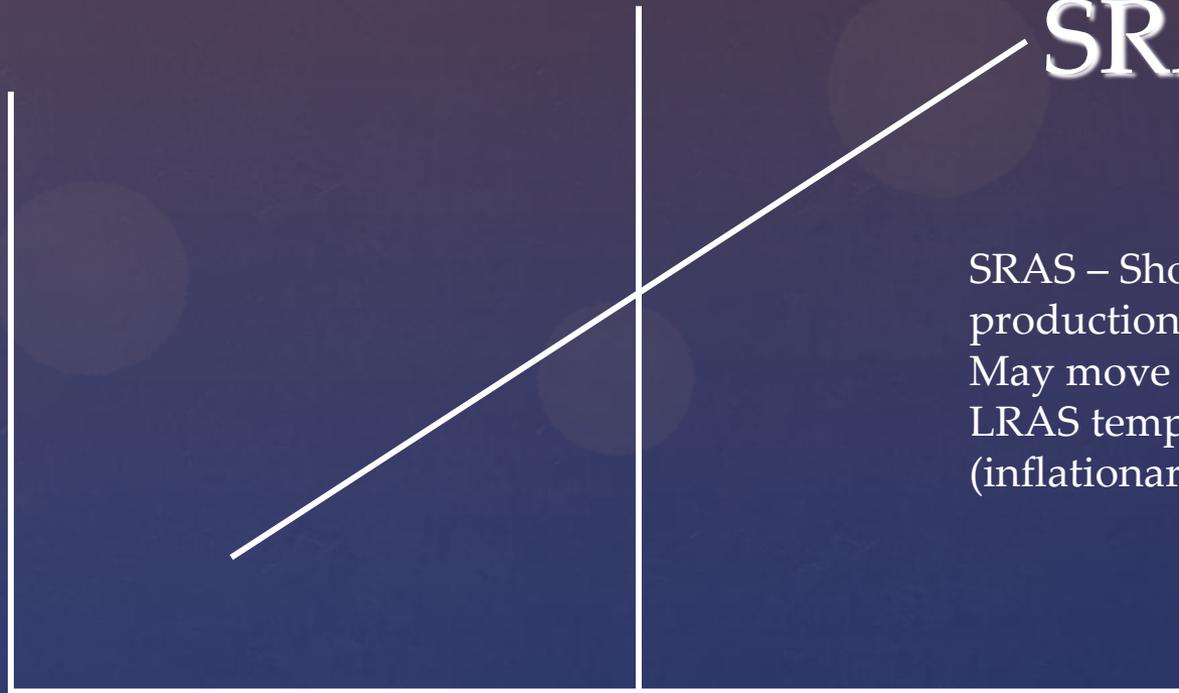
AS - The Model – (More common)

Aggregate Supply can change in the short run
vs. the long run!

PL

LRAS

SRAS



SRAS – Short run
production points.
May move beyond
LRAS temporarily
(inflationary gap)

RGDP

LRAS – Long run production point
limited by productive resources
THINK PPC!!!!
SHOWS FULL EMPLOYMENT!!

Here an economy is
in transition.
Moving toward full
employment.

What changes AS?

& Any change in **productive resources**

∅ $AS = K + L + C + E$ (land, labor, capital, entrepreneurship)

& Business regulations/taxes

Putting it together

Aggregate Supply can change in the short run vs. the long run!

